Reinvented Business Assistance Programs Promise To Do More With Less

Although appropriated funding has declined or remained constant for many of these programs, program activity levels are expected to increase for the main business credit programs that particularly benefit rural areas—small business loan guarantees and business and industry (B&I) loans and guarantees. To provide more assistance with less funding, Federal agencies have reinvented their programs, improving their efficiency. Many lending agencies are also streamlining their application processes and regulations, enabling more businesses to participate.

Rural businesses will be significantly affected by many legislative changes made in 1996, including changes in the minimum wage, new tax breaks for small businesses, new regulations covering insurance portability, and, most importantly, welfare reform. Increases in funding for education, training, and employment programs will ease the transition from welfare to work (these changes are discussed elsewhere in this report). However, funding did not generally increase for the business assistance programs that help create the new jobs that will make room for the new welfare workers. New budget authority has even declined for some of these programs, such as Small Business Loans and Guarantees.

Despite these declines in funding, the Federal agencies that provide business assistance are attempting to continue to expand the amount of credit available to rural (and urban) businesses, through various means. In some cases, they are making use of old funds by drawing down funds that were unobligated from last year. New funding sources, such as the Fund for Rural America, are supplying new funds for USDA's business and industry program.

These are short-term solutions. Potentially more important for the long run are the reinvention efforts these agencies are undergoing, aimed at improving efficiency and increasing program activity and performance. Among the new approaches being taken or proposed are (1) agency reorganizations and downsizing to reduce overhead costs and improve efficiency; (2) transferring some responsibilities and fees to private sector lenders in guaranteed loan programs; (3) streamlining regulations and application processes to attract new lenders and borrowers into the programs; (4) reducing the subsidies on direct loans to make appropriations go farther; (5) improving the selection process to better target assistance to firms and communities that need it most; and (6) increasing use of program evaluations and performance benchmarks to improve program performance.

We present the agency estimates of expanded program activity, as contained in the President's budget. Historically, these kinds of estimates have not always proven to be accurate, since they depend on many things, including the economy, which affects the demand for business loans and interest rate subsidy levels required on direct loans. More important, it remains to be seen whether Federal business assistance agencies can succeed in expanding program activity without receiving more funds, because the outcome from their reinvention efforts cannot be accurately predicted. If successful, however, rural businesses could benefit from these efforts for years to come.

Program Activity Expected To Increase in 1997

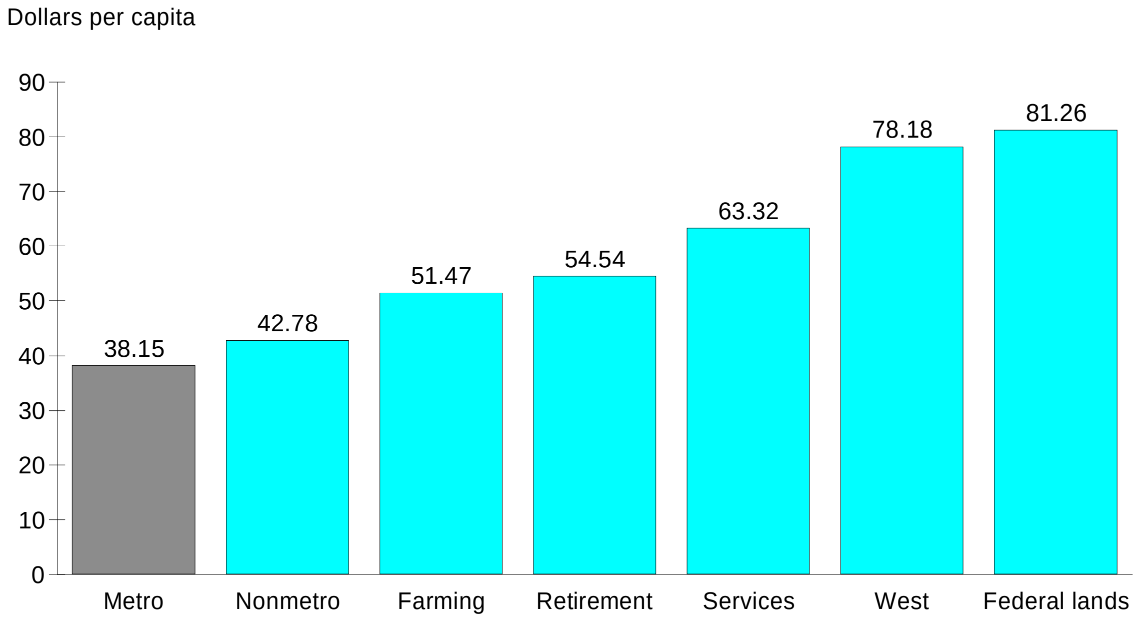
The Small Business Administration (SBA). SBA operates various programs that address different business needs. SBA's largest business loan program, the section 7(a) guaranteed loan program, is projected to increase its new obligations from $7.3 billion in 1996 to $7.8 billion in 1997 (all references to years refer to fiscal years). In past years, this program has particularly benefited nonmetro areas, many of which rely almost exclusively on small businesses for their employment. For example, in 1995, nonmetro areas received more in per capita Small Business 7(a) guarantee assistance than did metro areas; the nonmetro areas that benefited most were those in the West and in counties specializing in services, retiree attraction, and farming (fig. 1).

The second largest SBA program, the section 504 Certified Development Loan Company program, is increasing its obligations from $2.4 billion to $2.6 billion in 1997. In 1995, its loan guarantees were allocated about equally, on a per capita basis, between metro and nonmetro areas; among nonmetro areas, western counties and counties emphasizing service industries benefited the most (table 1).

Figure 1

SBA small business loan guarantees, by type of county, fiscal year 1995[1]

Small business loan guarantees disproportionately benefit rural areas in the West and those specializing in services.



[1] 7(a) General Business Assistance Program, only.
Source: Calculated by ERS using Federal Funds data from the Bureau of the Census.

SBA's main direct loan program provides disaster loans, including physical disaster loans and economic injury disaster loans. New obligations for SBA disaster loans are expected to decline from $867 to $747 million, but supplementary funding could add to this total in the event of major disasters in 1997. In 1995, metro areas in the West received the large majority of SBA's disaster loans, mainly in the form of physical disaster loans (by far the larger of the two direct loan programs). This was associated with the 1994 California Northridge earthquake. The smaller, economic emergency disaster loan program benefited nonmetro areas more than metro areas in 1995, with farming areas in the Midwest benefiting most.

USDA's Rural Business-Cooperative Service (RBS). RBS's main business assistance programs are the Business and Industry (B&I) program, the Intermediary Relending Program, and the Rural Business Enterprise Grants (RBEG) program. Smaller RBS programs include Rural Technology and Cooperative Development Grants ($2 million in 1997), Rural Business Opportunity Grants ($1 million), and Rural Economic Development Grants and Loans ($41 million). The latter two programs are covered in the article on general assistance.

The B&I program includes both guaranteed loans and direct loans. The larger guaranteed program is projected to provide $688 million in loan guarantees in 1997, up 8 percent from 1996. In 1995, B&I guarantees disproportionately benefited farming counties and Federal lands counties in the West. This program also is providing $50 million in direct loans in 1997; no such loans were provided in 1996. USDA's Intermediary Relending Program is projected to provide $37 million in loan guarantees in 1997, about the same as in 1996. The RBEG program grant level is $41 million in 1997, down 8 percent from 1996. This includes $6.5 million in grants from the Fund For Rural America in 1997.

Table 1

Selected business assistance programs

Most business loan guarantee programs are expected to increase their loan activity in 1997

Program	Program level by fiscal year[1] 1996 actual	1997 estimate	Change	Rural areas most affected by the program
	Billion dollars		Percent	
SBA 7(a) business loan guarantees	7.32	7.81	7	Services, farming, and retirement counties, in West
SBA Certified Development Loan Company guarantees (Section 504)	2.44	2.65	9	Services counties, in West
SBA disaster loans	.87	.75	-14	Places experiencing disasters
RBS Business and Industry loan guarantees (B&I)	.64	.69	8	Farming and Federal lands counties, in West
RBS Intermediary Relending Program guarantees	.04	.04	0	Services, farming, nonadjacent and poverty counties, in West and Midwest
RBS Rural Business Enterprise Grants (RBEG)	.05	.05	0	Totally rural, farming, and poverty counties, in West
EDA Economic Adjustment[2] Grants	.03	.03	0	Farming and totally rural counties, in West

[1]Budget authority used for grant programs; projected loan levels (obligations or program level) used for loan programs. Note that in some cases, budget authority may be falling at the same time that projected loan obligations are rising. This can happen for any number of reasons, including making use of greater efficiencies, reducing subsidies, charging fees, and using unobligated balances of funds from prior years.

[2]This represents just part of the larger EDAP program (see text); many of these grants are used to support revolving loan funds that issue loans to businesses, hence a larger amount of loans will result than is indicated by this budget authority amount.

Source: Budget of the United States, fiscal year 1998.

Commerce Department's Economic Development Administration (EDA). EDA operates another important program benefiting rural businesses, the Economic Adjustment Program. Some of the funding from this grant program is used to capitalize revolving loan funds that make loans to businesses in economically distressed areas. The budget for the Economic Adjustment Program remains steady at about $31 million in 1997.

Many other programs provide business assistance to rural areas (see *Rural Conditions and Trends*, Vol. 7., No. 2, for a list). One of the newest is the Community Development Financial Institution (CDFI) initiative, which helps finance businesses, housing, and other activities in distressed communities. This program is discussed in more detail in the article on general assistance.

Reinvented Business Assistance Programs

Government reinvention efforts arising, in part, from compliance with the Government Performance and Results Act (GPRA) are expected to improve program efficiency. Many agencies are counting on these efficiency gains to result in greater program benefits despite constant or reduced program appropriations. Some of these new initiatives are improving efficiency by shifting program activities to the private sector. Some are aimed at opening up the programs to new lenders and borrowers. Most involve streamlining regulations and application processes, reducing paperwork burdens on applicants. Priorities given to applicants in the selection process have been revised to match up loans better with deserving businesses and distressed communities. Many agencies have downsized and consolidated activities and instituted strategic planning with performance standards to monitor and guide future policy. Some agencies have moved toward more extensive program evaluation.

New B&I Guaranteed Loan Program Regulations. RBS has streamlined its regulations and paperwork requirements, making it easier for businesses to apply for assistance. RBS's new B&I regulations also pass some of the responsibility for loan documentation and analysis to lenders, thereby achieving new efficiencies.

The new regulations for the B&I program, announced in February 1996, were motivated in part by a Senate report on the fiscal year 1995 appropriations act, which contained a directive for streamlining the B&I regulations and application procedures. An internal review also found that many small borrowers avoided program participation because of costly program requirements and suggested some program costs could be reduced by shifting activities to the private sector.

The new regulations are streamlined and less paperwork must be provided to the agency, making it easier for borrowers and lenders to participate. New rules also increase the potential pool of lenders by allowing the agency to approve additional lenders with sufficient legal authority, lending expertise, and financial strength to act as lenders in the program. Agency operation costs are cut by reducing the amount of material that must be reviewed by the agency before approval of the guarantee, and responsibilities for credit analysis and application processing are being shifted from the agency's national office to field offices and to lenders where feasible.

A standard guarantee fee of 2 percent will be paid to the agency by the lender and is nonrefundable. The fee can be passed on to the borrower. The new rule allows for the guarantee fee to be reduced to 1 percent if the agency determines that the business is a high-impact business located in a community that is experiencing long-term population decline and job deterioration or located in a rural community that has remained persistently poor over the last 60 years. Each year, a limit will be established specifying the maximum portion of guarantee authority that will be available to guarantee loans at the 1-percent fee rate.

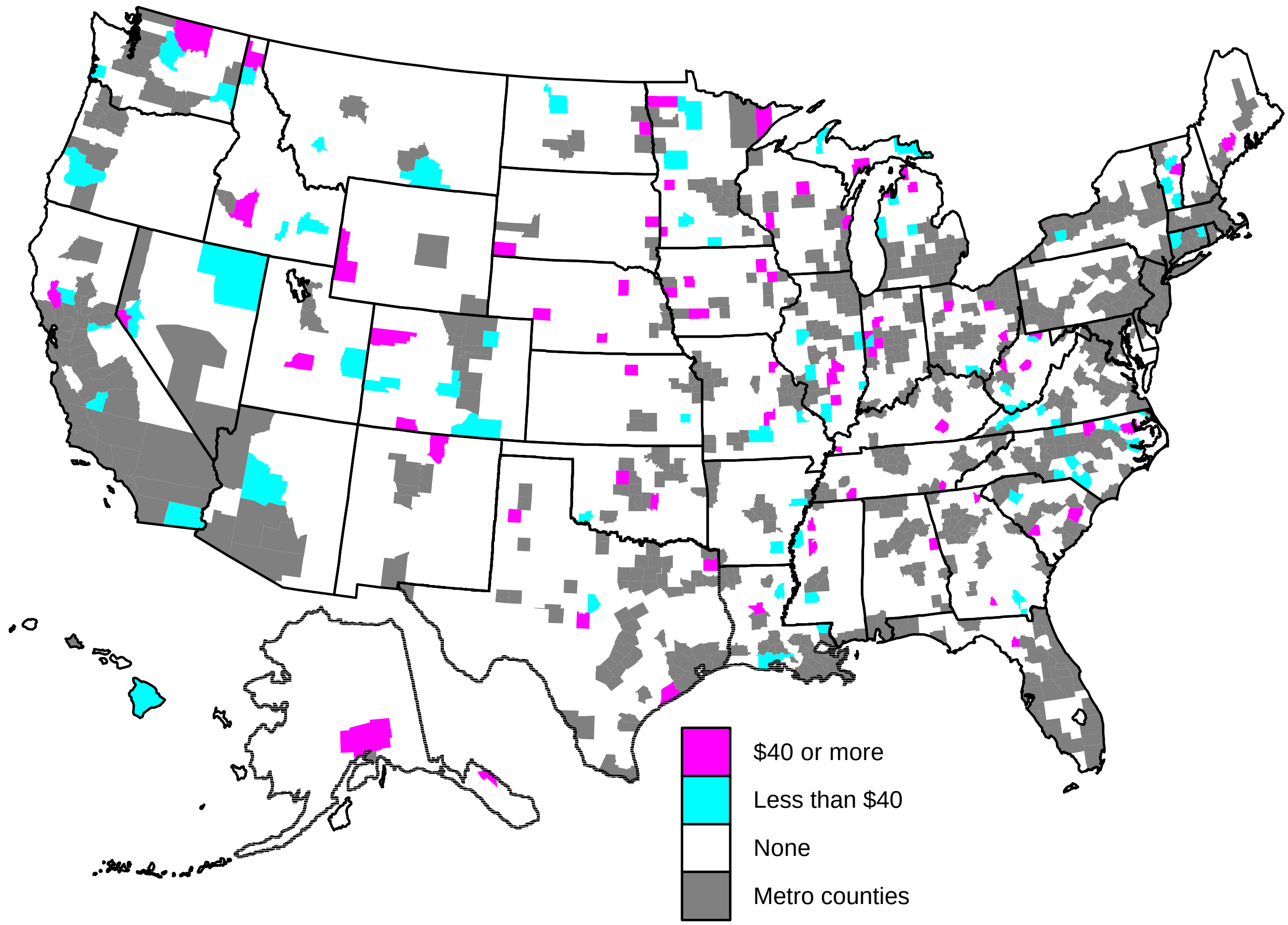
RBS loan priority is now given to nonmetro unincorporated areas and cities with less than 25,000 population, communities that have experienced long-term population decline, and rural areas that have remained persistently poor over the last 60 years. Empowerment zones will also receive preferential treatment. This may result in B&I guarantees being concentrated in certain regions more than in the recent past, when they were more scattered across the country (fig. 2).

A regulatory change mandated by the 1996 farm legislation authorizes the B&I program to issue guarantees for family farmers who sell their products to a cooperative. These loans to agricultural producers are only available when producers are not eligible for Farm Service Agency program assistance, and will be allowed only if the production is part of an integrated business involved in the processing of agricultural products. Examples include an apple orchard or poultry operation whose sales are tied to a particular food processing business.

Figure 2

Per capita business and industrial loan guarantees, fiscal year 1995

Assistance benefits many rural counties throughout the country



Source: Calculated by ERS using Federal Funds data from the Bureau of the Census.

EDA Reinvention Efforts. EDA has made much progress in reinventing its programs, including streamlining its regulations and applications process, reorganizing and downsizing its staff, and making greater use of program evaluations and performance measures. Beginning in the early 1990's, EDA discovered that the application process was extremely costly for applicants and the review process took so long that, in some cases, timely responses to community distress were not possible. EDA's response has been to streamline its regulations, including its grant application and pre-application forms. Beginning in 1996, EDA introduced a single application form for all applicants for EDA grants. This is expected to open up the program to businesses and other customers that might otherwise have avoided it. Applicants also benefit from reduced paperwork and quicker EDA reviews (within 60 days).

Following a review by Price Waterhouse and a reduction in funding by Congress, EDA has recently reorganized for greater efficiency and downsized its operations. Functions were consolidated, staff was cross-trained, and decisionmaking was decentralized, giving grant approval authority to six regional offices. Since 1995, EDA staff has fallen from 355 to 255 and its headquarters staff has been cut by 35 percent.

In October 1996, EDA began a series of evaluations of its major programs. These evaluations and new core program performance measures are already beginning to yield significant information that can be used to improve program performance.

SBA Proposals. In recent years, SBA has been developing performance measures to improve program efficiency. These efforts have already brought about some improvements in program performance, and further improvements are expected if SBA's current proposals can be implemented.

One proposal is to continue increasing its reliance on private sector partners. Three initiatives would allow SBA to complete its transition from physically servicing and liquidating its $36-billion loan portfolio to overseeing its private sector partners. First, section 7(a) general business lenders will be required to service and liquidate all loans approved after fiscal year 1997. Second, SBA will sell its $10-billion portfolio of defaulted guarantees and direct loans beginning in fiscal year 1998. Third, SBA wants to improve its portfolio-monitoring capabilities.

To stretch taxpayer dollars, SBA plans to have (1) the Small Business Development Companies charge counseling fees to make up for reduced Federal grants, and (2) disaster loan borrowers pay a higher interest rate, equal to the rate on Treasury securities of comparable maturity. Another SBA proposal would put additional resources into programs that give disadvantaged small businesses access to capital, education, and training.

A Pattern Is Emerging for the Future of Business Assistance Programs

The impact of these new performance measures and regulations is largely unknown. However, a pattern is emerging for the future of business assistance programs. Participating private sector partners will be shouldering a greater burden, verifying that borrowers meet program guidelines and seeing that program requirements are met. In return, private sector partners are supposed to receive a streamlined and less costly set of guidelines and paperwork. Program agencies will continue to downsize and reorganize to reduce costs, but they appear to be weathering these changes so far without sacrificing too much in program delivery. Program agencies maintain considerable control over how funds are distributed, and they seem to be more selective in targeting assistance to fit program objectives, such as assisting distressed communities. Program agencies also still have control over conditions that must be met before a loan can be classified as being in default, thus providing some control over default losses that the agency guarantees. *[George Wallace, 202-501-6751, gwallace@econ.ag.gov, and Rick Reeder, 202-219-0551, rreeder@econ.ag.gov]*